Comments to Sunset Commission

Texas Commission on Environmental Quality

December 15, 2010

RE: Proposed transfer of water and sewer rate making authority from Texas Commission on Environmental Quality to the Public Utility Commission

Background

Aqua Texas, SouthWest Water Company and SJTX appreciate the opportunity to present these comments and testimony to the Sunset Advisory Commission. Our particular interest in these comments concerns Recommendation S 1.4—the recommendation to transfer responsibility for regulating water and wastewater rates and services from TCEQ to PUC.

Both entities are investor owned utilities (IOU) that provide retail water and wastewater service to approximately 90,000 connections statewide. Each company has substantial sums of money in infrastructure improvement. For example, Aqua Texas has invested over $80,000,000 in capital improvements in Texas since 2005.

This amount of investment though large is to be expected, as water utilities are the most capital intensive industries. While, water utilities are the most capital intensive of all utilities. Studies have shown that for water utilities, it takes $3.29 in capital investment to return $1.00 in revenue. On the other hand, these same statistics show that it took $1.46, $1.41 and $1.13 in capital investment for electric, gas and telecom industries, respectively, to produce $1.00 of revenue. (NAWC Water Policy Forum VIII, April 2005)

Nationwide, the water and wastewater industry face a combined capital investment requirement near one trillion dollars over the next 20 years, according to the EPA.

Because of this capital intensive nature, and other reasons, Texas has long considered water utilities to be a natural monopoly. (*Water Code, 13.001)*. As a substitute for the normal forces of competition, Texas, through the TCEQ, regulates rates, operations and service.

The TCEQ sets allowable rates upon application by the utility. Other affected parties, namely the customers, are allowed to provide input during the process and present testimony. By law the utility must recover its cost of service, which includes "prudently" incurred expenses and a "fair" return on its capital investment in utility improvements.

Unlike municipalities, special districts and to some extent Water Supply Corporations, investor owned utilities are required to set rates based upon cost of service and may only generate revenue to pay for capital costs and expenses through customer rates. These other entities have alternate sources such as government grants, bond financing or taxes which may not be reflected in rates, but are certainly part of the bottom line. Also, since these entities are not required to charge the cost of service, certain operating expenses and/or capital investments may be charged to other departments or entities and therefore not be reflected in the water rates. Therefore, a straight comparison of rates charged by an IOU to a political subdivision is not a fair or accurate comparison.

Main Points

Fractured Oversight

Aqua Texas, SouthWest Water Company and SJTX believe that the current regulatory system for water utilities maximizes efficiency. Retail water and sewer IOUs must comply with state and federal requirements regarding wastewater discharges and stringent water quality regulations to provide safe and reliable drinking water service. The TCEQ possesses oversight of this. It is likewise reasonable, if not inspired, that the Texas Legislature has crafted the regulatory oversight of this industry so that the same agency that requires capital expenditures to meet clean water and safe drinking water regulations is the same agency that approves the rates which allow the utility the necessary funds to pay for the improvements. One could envision a scenario where a regulated entity could be caught between dueling agencies—the TCEQ requiring certain improvements to be made and the PUC challenging the need, cost and/or the magnitude for such improvements.

This is especially relevant in light of the above-mentioned fact that the water industry is the most capital intensive of all utility services. Further, as discussed, retail water and sewer IOUs are not able to "hide" rates for capital improvements in grants, taxes or through general obligation bonds. The current recommendation to transfer rate jurisdiction to the PUC on the grounds that it may offer potential benefits by aligning Texas' utility regulation within one agency, Aqua Texas and SJTX believe that such a transfer could and would lead to confusion and fractured oversight of the regulated water utilities. This is especially true since as explained above the water utility industry is significantly different from the energy and telecom industry since not only is it the only utility that provides an ingestible product and therefore rightfully is subject to stringent water quality regulation, but also since the capital requirements per dollar of revenue are so significant. Further, we see no increase in regulatory efficiency that could possibly lead to a cost savings to the rate payers or tax payers.

Capital Markets

The National Association of Water Companies (NAWC) in its 2005 Policy Forum, along with discussing that water utilities will be entering into their most capital intensive period in history, has also pointed out that capital markets necessary to provide funding for these necessary improvements relies on consistent regulatory treatment to cover the long-term nature of the environmental and infrastructure investments. (NAWC Water Policy Forum, April 2005) Standard and Poor's echoes the sentiment that a state's regulatory system is the defining factor in the ratings of a utility. "A Fresh Look at US Utility Regulation", S&P Utilities and Perspectives, February 2, 2004.

Texas has attracted, over the last several years, major water and sewer utility companies who have invested hundreds of millions of dollars into capital improvements for Texas water and wastewater. There are several likely reasons for this, not the least of which is the current Texas regulatory system. The industry, while not always agreeing with the TCEQ or the TCEQ staff, functions very well having the same agency that regulates compliance to be the same agency that regulates rates. The financial markets seem to believe the same as the industry continues to expand in Texas.

Benefit by Transferring rate making jurisdiction to PUC

Aqua Texas, SouthWest Water Company and SJTX disagree with what appears to be the Sunset Commission's staff's overarching belief—that the PUC is more capable of making rate-setting decisions. Water and wastewater ratemaking is not new to the TCEQ. It and its predecessor agencies have had jurisdiction in this field since 1986. Nothing has shown that the TCEQ staff cannot handle these matters or that the TCEQ Commissioners are not as capable as the Commissioners on the PUC. It should be noted that air quality jurisdiction did not come to the TCEQ's predecessor's until several years after water and sewer regulation was there.

Aqua Texas, SouthWest Water Company and SJTX also sees little proof in the assertion that moving the water and sewer rate regulation (including Certificates of Convenience and Necessity) to the PUC would "improve focus on TCEQ's core mission". Since water and sewer regulation has been at the TCEQ longer than has air quality regulation, it is difficult to imagine that water and sewer rate and CCN regulation are not part of the TCEQ's "core mission". Further, if the retail water and sewer rates and CCN regulations are not part of TCEQ's "core mission", then the TCEQ's jurisdiction over special districts such as MUDs, including review of bond applications, is not included in this recommendation.

In essence, the TCEQ has shown to be quite competent in this area of regulation. Aqua Texas, SouthWest Water Company and SJTX believe that there has been no adequate justification to move jurisdiction to another agency in light of the potential for disjointed regulation and possible uncertainty to the regulated community during a time of increasing capital needs.

Once again, we appreciate the opportunity to present this testimony and we look forward to working with the members and the Sunset Advisory Commission throughout the 82nd Session.